OFFICE OF AUDITS
MEMORANDUM REPORT 97-PP-016
NEED FOR A DEPARTMENTWIDE CONTRACT
TO PROVIDE DEFENSE BASE ACT INSURANCE
JUNE 1997

The Defense Base Act of 1941, Public Law 208, (42 U.S.C. 1651 et seq.) mandates insurance coverage that provides a broad form of workmen's compensation protection for certain types of non-U.S. Government personnel working on Federal projects abroad. Coverage is provided 24 hours a day and includes sickness, accident, injury, and death. Contractors can obtain coverage in various ways, including through an agencywide requirements or "blanket" contract, or agencies may allow contractors to obtain the insurance from a commercial insurance carrier or provide their own insurance. Defense Base Act (DBA) insurance is expensive because it provides higher benefits and is nearly all-encompassing based on the theory that, if it were not for the job and the overseas environment, a person would not be exposed to a particular hazard. To be eligible for such coverage persons must be U.S. citizens, Green Card holders, or foreign nationals hired and dispatched from the United States.

During a 1991 audit of this area, we recommended that the Department use a requirements contract for obtaining DBA insurance coverage because significant savings could be achieved, and the Department implemented our recommendation. Because the cost of DBA insurance had increased substantially under the requirements contract and Department officials had received complaints from construction contractors that the Department's DBA rates were no longer competitive, the Department asked us to review the contract to determine if a requirements contract was still the most economical means to obtain such insurance. We found that the increased costs resulted because of increased claims filed by the Department's contractors. Based on our current review, we found no compelling reason to discontinue a requirements contract approach.

As an alternative to the requirements contract, Department officials proposed going to an indefinite quantity contract, which would allow contractors to obtain coverage individually, outside the indefinite quantity contract, if they could obtain lower rates. Although we have no objection to such an alternative, we are not able to reach any conclusion on the suitability of this approach because of uncertainty about (1) the insurance rates for individual contractors that would be obtained under the indefinite quantity contract and under separate contracts and

(2) whether, and to what extent, individual contractors would elect to obtain coverage outside the indefinite quantity contract. Additionally, it is the contracting officer's responsibility to determine the appropriate contract type to be used based on any relevant information.

Apart from the Department's request, we found that the contracting officer had not monitored contractors' claims histories to determine whether trends exist and whether corrective actions are needed to reduce claims. We are recommending that the Office of Acquisition review contractors' claims histories during the preaward process when DBA insurance is required and consider including contractors' claims histories as part of the proposal evaluation process.

DEPARTMENT RESPONSE

A/OPR/ACQ agreed with the recommendations and stated that corrective actions had been or would be taken. A/OPE also agreed with the recommended actions and provided comments concerning the draft report. We considered the comments received when preparing the final report and incorporated changes as appropriate. Appendix B contains the comments received from A/OPE, and appendix C contains the comments received from A/OPR.

PURPOSE AND SCOPE

In April 1996, the Department's Office of the Procurement Executive (A/OPE) asked us to review the Department's DBA insurance contract to determine if a requirements contract was still the most economical means to obtain such insurance. A/OPE noted that over the past several years, insurance rates had increased 85 percent, and it was concerned that the blanket rates were no longer competitive with those available from commercial sources.

To accomplish our objective, we:

- reviewed the Department's current contract;
- reviewed procedures used by the Department, the U. S. Agency for International Development (USAID) and the Department of Defense to obtain insurance;
- compared rates paid by the Department, USAID, and Defense in recent years;
- analyzed the Account Experience Policy Summary Reports prepared by the Department's insurance carrier, which identify Department contractors requiring DBA insurance and include information on policies, premiums, and claims;
- reviewed applicable laws and regulations, contract files, and related reports;
- held discussions with contracting personnel in the Office of Foreign Buildings Operations (A/FBO), the Office of Acquisition (A/OPR/ACQ), and the Moscow Embassy Building Control Office (M/MEBCO); and

- contacted representatives from USAID, officials with active contracts with the Department, and various insurance brokerage firms to obtain insurance information.

Because the procedures performed do not constitute an audit performed in accordance with generally accepted government auditing standards, we do not express an overall opinion on the effectiveness of the Department's procedures and practices for obtaining insurance. Had we performed additional procedures or had we conducted an audit in accordance with generally accepted government auditing standards, other matters might have come to our attention that would have been reported.

The review was performed by the OIG's Office of Audits, Property Management and Procurement Division between July and December 1996. Major contributors to this report included Jerry Huffman, division director; Ken Comer, audit manager; Tony Jones, senior auditor; and Dale Lawver and Margery Wimmer, auditors.

BACKGROUND

In 1941, Congress enacted the DBA, which provides worker's compensation protection to employees of Government contractors engaged in work overseas. It is an extension of the Longshoreman and Harbor Worker's Compensation Act, which is intended to provide equitable coverage for individuals working outside the United States. The costs of the insurance coverage are passed through to the Department by its contractors.

A Department of State, USAID, and United States Information Agency task force, as part of the *President's Private Sector Survey on Cost Control* in the Federal Government, reported in 1983 that DBA insurance costs had been reduced by 50 percent at USAID by using blanket contracts. The report claimed that application of a similar program at other foreign affairs agencies could substantially reduce their insurance costs.

In response to an August 1990 request from the Department, the OIG contracted with a CPA firm to perform an audit of DBA insurance. The Department's request stemmed from its interest in reducing insurance costs, a possibility initially raised by a private citizen. The audit reviewed DBA insurance costs and related administrative procedures to determine whether an alternative approach would be feasible and result in cost savings. At the time of the audit, the Department's contractors obtained DBA insurance through independent means and their insurance rates varied based on factors such as the company's size, claims history, and work location. The audit disclosed that DBA insurance costs could be reduced by about 40 percent if the Department obtained a blanket insurance contract similar to that used by USAID.

As a result of the 1991 audit, we recommended that the Department determine whether its DBA insurance needs could be best satisfied by establishing a requirements contract for DBA insurance similar to USAID's. The Department concurred with the recommendation and awarded a blanket requirements contract in May 1992 to CIGNA Property and Casualty

Insurance Company. This contract provided coverage for a 2-year base period and included options to renew the contract for three 1-year periods.

The blanket requirements contract has an escalation/de-escalation clause allowing the insurance company to make rate adjustments for the option years based on a standard formula. The formula includes an experience rating factor consisting of (1) an adjusted loss ratio that is calculated by dividing the total claims incurred by the total premiums of the experience period, (2) a break even loss ratio that reflects the ultimate loss ratio, that is, the loss ratio after all claims have been reported to and settled by the company, and (3) a creditability factor that adjusts the modification to reflect the volume of exposures--that is, as the exposures increase the creditability factor increases. The formula also considers the percentage increase or decrease in the medical component of the consumer price index and the percentage increase or decrease in the maximum benefits for disability or death as prescribed in section 6 of the U.S. Longshoremen's and Harbor Worker's Compensation Act, based on the average weekly wage.

Under a blanket requirements contract, an insurance company guarantees a single premium rate to all contractors. This rate should be lower than commercial rates that can be obtained by many companies because of the large volume of business. All Department of State contracts covered by the DBA are required by the terms and conditions of their contract to procure insurance coverage from the specified insurer--including smaller contractors that otherwise might have difficulty in obtaining DBA insurance--unless a contractor is approved as a self-insurer by the Department of Labor. The blanket requirements contract also avoids minimum premium payments imposed by insurance brokers for companies that only need to purchase a small amount of insurance.

AUDIT RESULTS

The results of our review are provided in the four sections that follow on:

- the Department's DBA insurance experience under its blanket requirements contract, showing the relationship between claims history and rate increases;

- USAID's DBA insurance experience under its blanket requirements contract, showing that it did not encounter similar rate increases because it had a better claims record;

- Department of Defense's DBA insurance experience with individually awarded contracts; and

- our analysis of Department officials' concerns about the increasing blanket requirement contract rates and the efficacy of changing from a blanket contract to an indefinite quantity contract.

Department Of State Experience

Current rates paid by the Department's contractors for both construction and services contracts are 72 percent higher than the rates paid at the beginning of the contract. However, rate increases probably would have been even higher for many individual contractors if the Department had continued its previous practice of requiring contractors to obtain DBA insurance individually. The following table illustrates the changes in rates since the beginning of the contract.

Contract Period		Construction Rate per $100 of Labor		Services Rate per $100 of Labor
2 Base Years (1992-4)		$5.12		$3.85
Option Year 1 (1994-5)		4.76		3.57
Option Year 2 (1995-6)		8.02		6.02
Option Year 3 (1996-7)		8.82		6.62

DBA Insurance Cost Comparison

For four contractors, we compared hypothetical DBA insurance costs for 1992 through 1994 under the Department's blanket requirements contract with the actual costs of individually obtained insurance for 1991. The hypothetical costs under the blanket contract were lower by about $30,000 each for 1992 and 1993, and about $60,000 for 1994. Our projections were based on (1) the contractors' independently obtained insurance rates for 1991, (2) the Department's blanket contract rates for 1992 through 1994, and (3) the contractors' actual 1991 labor costs. The 4 selected contractors were from 15 contractors with individually obtained insurance coverage in 1991, as reported in our previous report. We selected them because they were subsequently covered under the Department's blanket contract.

We did not determine and use actual labor costs for 1992 through 1994, because the 1991 labor costs were readily available from our previous report. The additional effort to determine actual labor costs for 1992 through 1994 was not warranted. It might have changed the amount of the cost difference (either up or down), but blanket insurance would have remained less costly because of its lower rates. Our comparison also does not reflect the likelihood that any claims filed by the contractors might have increased their insurance rates if they had continued obtaining their insurance independently. Each of these four contractors did, in fact, file DBA insurance claims in the 1992 through 1994 period.

Claims History

Based on our analysis of the Account Experience Policy Summary Report prepared by CIGNA, the rate increases resulted from a significant number of contractor claims. Since the beginning of the contract through August 5, 1996, CIGNA issued 335 policies that provided coverage for 392 contracts. Premiums for these 335 policies totaled about $4.3 million. Contractors filed 201 claims totaling almost $5.4 million, about $1.1 million more than the premiums paid during the same period. The amount of claims paid account for the rate increases over the life of the contract.

The Department's more favorable claims experience in the past 2 years should result in lower rates in the future and if the more favorable claims experience continues, the rates could be lowered even further. An analysis of contractors who submitted insurance claims showed that claims exceeded premiums for the 2-year base period of the contract. However, premiums exceeded claims in policy period year ending April 30, 1995. The high claims filed during the contract's base period caused the higher rates in subsequent option years of the contract.

Schedules detailing the contractors who submitted claims, premiums paid, number of claims, and claim amounts are shown in the appendix. The following information summarizes each contract year.

- For the policy year ending April 30, 1993, a total of 50 policies were effective with 23 claims for 10 of the policies totaling $552,597.

- For the policy year ending April 30, 1994, a total of 67 policies were effective, 16 had 79 claims totaling $4,196,589.

- During the policy year ending April 30, 1995, a total of 110 policies were effective of which 12 policies had 77 claims totaling $610,187.

- Five of the 90 policies effective for the policy year ending April 30, 1996, had 22 claims totaling $22,603.

Some contractors submitted claims in four consecutive contract periods. For example, one contractor submitted 55 claims totaling about $3.8 million over a 3-year period. Another contractor filed 44 claims totaling over $400,000. Several other contractors submitted eight or more claims since the DBA contract was awarded in May 1992 through August 1996. Furthermore, the firms that submitted claims were responsible for most of the labor costs insured during the period of the contract. Although specific data was not available, we estimated that during the first four policy years, the DBA contractor insured labor costs totaling about $94.5 million. Although claims were submitted on only 43 of the 335 policies, the 43 policies covered about $62.1 million in labor costs, or 65.8 percent of the total.

The Department should consider contractors' claims history when awarding future contracts requiring DBA coverage since claims adversely affect insurance rates. The contracting officer (or the contracting officer's representative) should monitor contractors' claims histories to determine whether trends exist and whether corrective actions are needed to reduce claims. This information could then be used to correct problems that contribute to higher rates. For example, if a contractor's claims are attributed to deficient safety programs, the Department could require the contractor to provide information to correct the problem, such as a comprehensive safety program, before exercising subsequent option years of the contract. If contractors fail to take corrective action, the Department will then have a basis for re-competing the contract.

Considering a contractor's claims history, and the reasons for any claims, in the awards process would place emphasis on the importance of reducing claims. We believe this is important, especially considering that DBA insurance costs are costs that are passed from the contractor to the government.

> **Recommendation 1:** We recommend that the Office of Acquisition monitor claims under the Defense Base Act insurance contract to identify trends and initiate needed improvements.
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> **Recommendation 2:** We recommend that the Office of Acquisition review contractors' claims history during the preaward process when Defense Base Act Insurance is required and consider including contractors' claims histories as part of the proposal evaluation process.
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> The Office of Acquisition agreed with both recommendations.

U.S. Agency For International Development Experience

In contrast to the Department's experience with a blanket requirements contract for DBA insurance, USAID experienced smaller rate increases. USAID has contracted with CIGNA for almost 20 years. Since the beginning of the current contract, rates for both construction and services have decreased 5.5 percent. The following table provides an overview of the rate changes under USAID's current contract.

Contract Period		Construction Rate per $100 of Labor		Services Rate per $100 of Labor
2 Base Years (1992-4)		$4.20		$3.30
Option Year 1 (1994-5)		5.45		3.30
Option Year 2 (1995-6)		4.66		3.66
Option Year 3 (1996-7)		3.97		3.12

USAID paid premiums totaling about $10.6 million for 820 policies issued from 1993 to 1995. Only 39 claims totaling $351,936 had been filed against these policies. USAID's low claims record accounts for its lower insurance rates.

Department Of Defense Experience

Defense did not have a blanket requirements contract for DBA insurance coverage. Instead, Defense contractors individually obtained DBA insurance from commercial sources. Congress requested Defense to perform a review of the feasibility and desirability of creating a Defense-wide contract. However, in a study completed in April 1996, Defense concluded that the circumstances that led USAID and the Department to change to a blanket contract--exorbitant rates, contractors having difficulty obtaining coverage, significant number of contractor personnel overseas for short periods of time, and the insurance industry dissatisfaction with current procedures--did not exist within Defense.

Defense reviewed a mix of 20 contracts requiring DBA coverage. The selection included large and small contracts with labor categories for services and construction. Rates ranged from $.60 to $14 per $100 of salaries with a weighted average of $4.76 per $100. Defense compared this weighted average to the Department's blanket rates of $8.02 per $100 for construction and $6.02 per $100 for services to justify it's position that it did not need to alter its practice of requiring contractors to obtain DBA coverage through independent means.

However, using the Department's then current $8.02 rate for comparison purposes is problematic since that rate resulted because of the unfavorable claims experience during the first 2 years of the contract. As shown in the table on page 5, the Department paid rates of $4.76 per $100 for construction and $3.57 per $100 for services before the rates increased due to claims. The following information illustrates the average rates used by 19 of 20 sampled Defense contracts. One contract was excluded because coverage was not within the scope of our analysis. Six of the 19 contracts covered 2 contract periods.

Contract Period	Number of Contracts	Average Construction Rate	Number of Contracts	Avg. Services Rate
FY 1993	3	$9.01/$100	1	$1.33/$100
FY 1994	4	$6.28/$100	1	$3.84/$100
FY 1995	3	$6.67/$100	8	$2.30/$100
FY 1996	1	$5.40/$100	4	$3.03/$100

During the course of this review, we identified one contractor who has had overseas contracts with both the Department and Defense. This contractor was dissatisfied with Defense's current practice of requiring contractors to obtain coverage individually. The contractor claimed that the rates it paid were too high and believed that Defense should adopt a blanket contract.

Department Concerns

Contracting officials in A/OPR/ACQ, A/FBO, and M/MEBCO stated that some contractors have told them that they could obtain insurance at a lower rate than that currently provided under the Department's contract. We contacted these contractors and found that they could not provide evidence that they could get significantly cheaper rates on the commercial market.

Contracting officials identified seven contractors who they said could provide information on the availability of lower rates obtained on a commercial basis. Only four of the seven, however, told us that they could get lower rates, and only one of the four actually quoted a specific rate, which was $8.02 for each $100 of construction labor costs, or $.80 lower than the Department's current rate. Of the remaining three contractors, two did not believe they could obtain a lower rate, and the third was uncertain.

Discussions with 10 insurance brokers that provide DBA insurance did not provide sufficient data to conclude which method of obtaining coverage was best. Five of the brokers provided individual coverage, two provided blanket coverage, one provided both, and two elected not to furnish such information because they would first have to contact their underwriters. Of the 10 brokers, 8 did not have information on rates charged. One broker, which happens to be the broker for the USAID blanket contract, said it charged $3.66 per $100 of payroll for services contracts and $4.66 per $100 for construction. The remaining broker said that the average rates of all of its contracts are $3.00 per $100 for services and $5.00 per $100 for construction.

The increases in DBA insurance rates resulted from the large amount of claims submitted by a small number of contractors in recent years. Consequently, rates that all contractors must pay were increased to offset the claims costs of a few contractors. However, as stated earlier, the small number of contractors that submitted claims accounted for a significant portion of the total labor costs insured under the contract. Over 65 percent of the total labor cost for the 4-year period reviewed was for just a few contractors with claims.

Contracting officials also expressed their belief that it would be more effective to have an indefinite quantity contract to secure a rate available to Department contractors, but to also allow contractors to obtain their own coverage if they could do so at lower rates. The officials felt that the Department should have some form of contract in place to provide insurance at specific rates, rather than requiring all contractors to obtain their own insurance because it would allow smaller firms with no track record to obtain coverage at affordable rates. Firms with poor claim histories that otherwise would pay much higher rates can also obtain coverage that is more affordable.

A/OPR/ACQ officials also stated that competition is the key to maintaining lower rates and suggested that the Department's going to an indefinite quantity contract could save money because it would allow (1) the Department to award more contracts after the guaranteed amount of business had been met and (2) as stated earlier, contractors to obtain DBA coverage independently if they could find a lower rate. A/OPR/ACQ officials indicated that if this approach was adopted, insurance companies would still be interested in providing coverage to the Department because they need and want the business. We were unable to assess the viability of this approach because we were not able to predict either the rates that insurance brokers would offer or the extent to which construction and services contractors would elect to obtain DBA insurance outside the indefinite quantity contract.

Conclusion

We could find no compelling reason to discontinue the blanket requirements contract. In our opinion, the blanket requirements contract resulted in lower insurance costs than would have been incurred if contractors had obtained their own insurance. The cost of the DBA insurance was less than the amount of claims paid by the provider. Although the insurance rates have increased since the beginning of the contract, these increases resulted from the large number and value of claims filed by the Department's contractors in the first 2 years of the contract. Because contractor claims have decreased since that time and because the new contract would be competitively awarded, future rates may be lower.

We found no conclusive basis to suggest that the Department should go to an indefinite quantity contract. Not knowing (1) the insurance rates that would be obtained under an indefinite quantity contract and under separate contracts that some contractors would elect to employ or (2) the extent to which contractors would elect to obtain separate insurance makes any such determination difficult and speculative. However, as implied in the Office of the Procurement Executive's comments on our draft report (appendix B), it is the contracting officer's responsibility to determine the appropriate contract type to be used; and the decision should be based on any relevant information, including input from offices and bureaus where contracts require DBA coverage.

Appendices:

- A - Tables 1 through 4 showing contractor claims
- B - Office of the Procurement Executive's Comments to the Draft Report
- C - Office of Acquisition's Comments to the Draft Report

Table 1 - Contractor Claims for Policy Period 4

Contractor	Contract Period	Premium Amount	Number of Claims	Amount
Greenway Enterprise, Inc.	95-96	$111,814	6	$ 533
Bill Harbert International Construction, Inc.	95-96	190,074	8	4,586
Dyncorp Support Services Division	95-96	147,537	1	2,001
Spectrum Electrical Services, Inc.	95-96	7,258	1	2,480
Coastal International Security	95-96	51,877	6	13,003
Totals - 5 policies		$508,560	22	$22,603

Table 2 - Contractor Claims for Policy Period 3

Contractor	Contract Period	Premium Amount	Number of Claims	Amount
Beta Analytics	94-95	$ 87,017	7	$ 29,137
Fishbach and Moore International Corp.	94-95	58,569	2	9,500
Greenway Enterprises, Inc.	94-95	76,860	14	72,914
Ebon Research Systems	94-95	10,200	1	8,310
Bill Harbert International Construction, Inc.	94-95	288,411	26	191,429
Abatement Environmental Resources, Inc.	94-95	10,799	1	23,118
Dyncorp Support Services Division	94-95	139,997	8	4,917
The Roybal Corporation	94-95	4,388	1	0
Dillingham Embassy Constructors	94-95	159,698	8	190,949
Coastal International Security, Inc.	94-95	65,435	6	68,790
Cosmopolitan, Inc.	94-95	22,432	2	10,031
MVM Inc.	94-95	127,318	1	1,092
Totals - 12 policies		$1,051,124	77	$610,187

Table 3 - Contractor Claims for Policy Period 2

Contractor	Contract Period	Premium Amount	Number of Claims	Amount
Perini Corporation	93-94	$54,439	2	$ 4,270
Tomorrow's Environmental Concerns	93-94	1,844	1	50
Beta Analytics	93-94	46,359	3	16,049
USATrex International, Inc.	93-94	77,727	2	21,962
Caddel Construction Company, Inc.	93-94	44,659	1	5,913
J. A. Jones Construction Company	93-94	62,112	6	74,185
Greenway Enterprises, Inc.	93-94	16,273	2	70,521
Bill Harbert International Construction, Inc.	93-94	147,309	7	192,042
Facilities Development	93-94	17,022	1	2,350
Morrison Construction Services, Inc.	93-94	20,004	1	20,030
G & C Enterprises	93-94	27,163	1	705
Dyncorp Support Services Division	93-94	195,504	46	3,783,128
Kim Van Company	93-94	5,268	1	3,300
Dillingham Embassy Constructors	93-94	46,369	2	1,856
The Roybal Corporation	93-94	8,017	2	226
Integrity Private Security Services	93-94	444	1	2
Totals - 16 policies		$770,513	79	$4,196,589

Table 4 - Contractor Claims for Policy Period 1

Contractor	Contract Period	Premium Amount	Number of Claims	Amount
USATrex International, Inc.	92-93	$136,476	6	$185,800
Caddel Construction Company, Inc.	92-93	12,920	1	100
Greenway Enterprises, Inc.	92-93	7,404	1	509
Bill Harbert International Construction, Inc.	92-93	54,675	3	38,594
Lea/Passantino & Bavier	92-93	589	1	400
MVM Inc.	92-93	154,493	3	653
G & C Enterprises	92-93	66,802	2	4,574
Morrison Construction Services, Inc.	92-93	13,232	2	286,233
Morrison Construction Services, Inc.	92-93	7,235	1	35,129
Morrison Construction Services, Inc.	92-93	7,376	3	605
Totals - 10 policies		$461,202	23	$552,597